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Comparison of investment costs for companies using EU structural funds and investment incentives

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Abstract

The aim of this paper is to compare the various forms of public support for the company, specifically European subsidies from structural funds and investment incentives in the Czech Republic. Both of these public financial instruments are supposed to support company's investment but are these tools able to compansate costs that companies have to spend for them? In the research there are four types of investment costs defined: costs of completing application, investment costs, costs of subsidy management and sustainability costs. All of these costs are explained for each instrument with respect of application process. The presented results show that European subsidies are less expensive for the examinated company in spite of fact that application process is a heavy administrative burden. Appart from investment incetives that have easier application process, the investment costs are compansated by minority part of the investment incentives. The great item of investment incentives represents sustainability costs that might be covered by provided amount of tax relief. The investment incentives are certain risk that the invested costs may not be entirely covered by the investment incetives. At the end the paper compares costs of two companies defined as small and medium enterprises. Each company applied for one of the examinated financial instruments. The used methods for this paper are search inquiries, expert estimates, comparison and explanation. Theoretical approaches are examinated in a case study of two companies that have received EU subsidies and investment incentives in the Czech Republic. The results also rely on previous results of research project.

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Keywords: European fund; investment incentive; regional policy; regional development

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1. Introduction

Subsidies from European Structural and Investment Funds (ESIF) and investment incentives are an indispensable form of financial support for small, medium-sized and large companies in the market. Both forms of aid attempt to make it easier for companies to handle the tough competitive environment, to motivate companies to grow and to strengthen the region in which the company operates, or to which investment incentives have been trying to attract companies. The purpose of both forms of support from the provider is to bring about a positive effect on the region and companies. Nonetheless, the use of particular forms of support can also result in related costs for companies. A company's costs may consist mainly of costs for preparation of applications for aid, realisation of investments and costs related to compliance with the provider's set conditions until the aid provision period ends (in the case of incentives) or until the sustainability of the project ends (in the case of EU subsidies). If a company decides to apply for any of the specified types of financial support, the company must first prepare an application, including required accompanying documents. In this respect, the requirements for preparation for both types of support vary, depending on the scope of the application and the complexity of its processing. Differences can also be found in the likelihood of application approval. Based on a specific example, this Article will explain and outline how company's costs for investment incentives and costs for subsidies from ESIF differ.

The first research part defines individual types of financial support for companies and briefly summarises the requirements and conditions that companies must fulfil when submitting applications. It also characterises the Northeast Region, from which the companies selected for the case study originate. The second part will briefly introduce the particular companies and focus on their costs. It will define costs from the point of view of EU subsidies and from the point of view of investment incentives and will compare companies' costs for obtaining and keeping individual financial support using an example of an already realised project. The individual costs are referred to depending on the phase of realisation of the investment project for which the investment incentive or ESIF subsidy is to be obtained. The final part summarises the results determined in the case studies and points out which public support brings the investor higher costs related to the realisation of the supported investments.

2. Methods

The first phase of the research involved a detailed analysis of legislative documents resolving the issues of investment incentives in the Czech Republic and European legal documents related to ESIF and subsidy programmes in the Czech Republic. From those documents, relevant data has been selected along with information to be used for further research. The source of the conclusions used in the introduction comprises the results of previous research within the scope of the entire project. Research of literature and realised projects has been used to define various types of costs related to individual types of financial support. The source of data for the research has been information from market research conducted by expert companies providing advice regarding subsidies. Information about offers of services and prices was used. A comparative method was used to assess both forms of financial support, and a descriptive method was used to formulate conclusions regarding the comparison. In the second phase of the research, the focus was on a specific case of a realised investment incentive, which was compared with a realised project financed from ESIF, from the point of view of incurred expenses for application preparation, the particular investments into material fixed assets, costs for subsidy management and sustainability costs. Within this phase, the method of expert estimation was used, based on market research, in relation to calculation of costs for both cases. The sources of the data were the particular companies' financial statements. In conclusion, both types of financial support are compared from the point of view of their financial costs for the company.

3. Theoretical Approaches

3.1. Characteristics of the Northeast Region

For the purposes of this article, case studies were carried out in companies that have received investment incentives and EU subsidies in the Northeast cohesion region. The Northeast cohesion region includes the Liberec, Hradec Kralove and Pardubice regions. This is the third largest cohesion region in the Czech Republic and covers around 15.5% of the country's territory. The Northeast Region generates 81.8% of GDP (national average). The monitored region is focused on industry, previously mostly involving the glass and textile industries. The industrial character of the region is also reflected in the composition of companies with more than 100 employees, 98% of which are focused on the processing industry. The education level of the economically active population is 36% without a secondary school diploma and 33% with a secondary school diploma (Czech Statistical Office, 2014). A total of 37% of the economically active inhabitants are employed in the processing industry (Czech Statistical Office, 2014). These values show the significance of support in the region for development of companies located there.

3.2. Investment Incentives

Investment incentives can be defined in many ways, but the definitions differ in the broadness of the explanation of the term. In the Czech Republic's conditions, the investment incentives are best highlighted by Srholec (2004), who explains them as a measurable value provided to specific companies or groups of companies, so that they behave a certain way. UNCTAD divides investment incentives into three types: fiscal, financial and others. Fiscal types can include incentives such as tax holidays or reduced tax rates. Financial incentives include direct grants or loans at concessionary rates. The group of other incentives includes subsidized infrastructure or service, market preferences and regulatory concessions (UNCTAD, 2014). All of the types of the mentioned investment incentives are known to exist in the Czech Republic's conditions. The most common type of investment incentive is a tax discount calculated as eligible costs in the form of two annual wages in relation to the number of newly created jobs or amounts invested into fixed assets. Based on the two eligible types of costs specified above, the recipient of the investment incentive may decide which investment incentive will be more worthwhile. It is also possible to obtain an investment incentive as a subsidy for job creation or a contribution for employee retraining. However, that type of investment incentive shall be valid only for regions with higher unemployment than the national average. In the case of the Northeast Region, this type of investment incentive is not applicable, because it does not fall within the defined region, and investors can only apply for an income tax discount as an investment incentive (Czechinvest, 2014).

Act No. 72/2000 Coll., on investment incentives, as amended, defines an applicant for an investment incentive as a domestic or foreign business operator planning to make an environmentally beneficial investment in the Czech Republic (the Act, 2015). A business operator may apply for investment incentives without limitation, and if the business operator fulfils the general conditions, this increases the operator's chances of being promised an investment incentive. The application process is not complicated, and if there are missing documents or if there are any other uncertainties, the applicant can be asked to add them during the approval process, without the need for the application to be rejected (Brzakova, Pridalova, 2015). A factor associated with investment incentives is that general conditions must be fulfilled that exactly define the amount of the investment and the number of created jobs (investment output). However, both conditions are difficult for small and medium-sized enterprises to fulfil. The law also defines an area, which within the scope of investment incentives is supported, which results in the selection of applications from other unsupported sectors (the Act, 2015).

3.3. Subsidies from ESIF

European Structural and Investment Funds (ESIF) are basic instruments of EU policy for achieving the EU's objectives. The main objectives of the ESIF include supporting business development and supporting business innovation initiatives via the European Regional Development Fund (European Union, 2012). The ESIF provide subsidy aid to member states and their regions based on their economic situation, mainly based on the particular region's GDP. The EU defines subsidies as "any aid granted by the State or through State resources in any form whatsoever" based on Rubini's analysis (Rubini, 2010). The author further defines subsidies more specifically as a financial benefit to recipients of aid from any EU fund. This financial advantage is provided to selected recipients in the form of non-returnable loans with a certain scope. The amount of a subsidy varies depending on the characteristics of the recipient and those of the project. The applicant plans the amount of the project budget in the project application and the amount of the subsidy is then determined based on a percentage from the applicant's budget. The recipient receives the grant either ex-ante or ex-post, depending on the amounts of incurred costs (Regional Council, 2014).

Each applicant must fulfil the conditions of the operational programmes and individual calls for submissions. A qualified applicant must be headquartered in the Czech Republic and must be responsible alone for the implementation of the project. An applicant's eligibility, depending on their legal form, is determined by individual calls for submissions; in general applications may be submitted by SMEs, regional authorities, municipalities, regional administrative units, NGOs, associations and organisations comprising individuals and legal entities (Regional Council, 2014).

Based on individual calls for submission, it is necessary to create a project application, which must contain a specific description of individual sub-activities, the sources of activities and investment output. The project application must also be accompanied by a large number of additional documents, which identify the applicant and document the applicant's interest. In total, it is necessary to include around 40 annexes, but they are not all mandatory for every applicant. Required and important documents include proof of legal form, evaluation of the applicant's financial health, a detailed budget, a study of economic evaluation of the project, construction documentation, proof of ownership rights, the impact of the project on the environment, proof of partnership in the project, etc. (Regional Council, Annexe No. 2, 2014). Preparation of an application is a very complex process and requires thorough and time demanding preparation of all of the required documents. Even so, applicants have no certainty that they will receive the requested grant. The outcome of the efforts made in preparation of the application is very uncertain.

4. Results

4.1. Investment Incentives

The process of applying for an investment incentive requires submission of required documents and fulfilment of general conditions based on the set amount of the investment in a certain sector and specification of output in the form of the number of jobs created. Although it may seem that the investment incentive application process is not as complicated as for EU grants, the initial selection of applications occurs already under the mentioned general conditions. Based on the type of region, the investment amount must not be less than CZK 50 million, and the company is also required to create a certain number of jobs as required outputs. The minimum amount of the required investment depends on the type of sector and the region where the investment will be made. There are also defined areas that are supported by the investment incentive: the processing industry, technological centres, strategic service centres and share service centres etc. For some companies, mainly SMEs, it is very difficult to fulfil such set conditions (the Act, 2015).

The costs that a company may incur during the process of applying for, realising and maintaining investments may be divided as follows for investment incentives:

1. Costs for application preparation – If a company decides to apply for an investment incentive, it may complete the necessary documents itself, or engage an advisory firm. If the applicant decides to submit an application alone, the applicant will hardly incur any costs, other than administrative costs for verifying necessary documents. However, if the applicant decides to use advisory firms' services, the company shall incur costs for preparing the application. The amounts of such costs differ greatly depending on the scope of used services from advisory firms. These costs are therefore difficult to calculate.

2. De facto investment amount – this is the investment amount that the applicant plans to invest into property and machine equipment for the particular investment activity. The minimum amount of investment depends on the type of the region and the supported sector already in the general conditions of the investment incentive.

3. Sustainable costs – the law specifies the period during which the recipient of an investment incentive must maintain property and the jobs created with the help of the investment incentive. The recipient incurs these costs during the period of drawing the investment incentive, but for at least 5 years. During that period, the recipient incurs costs related to investment sustaining. So such type of costs is also figured into costs connected with the investment incentive.

Case study - Investment incentive

The previous part of this document defined the basic costs that companies can incur if an investment incentive is obtained. This part will identify the costs calculated for the specific company, labelled as a small or medium-sized enterprise that obtained the investment incentive. Table 1 specified below includes key information about a company, which during 2007–2013 carried out an investment activity in the Northeast Region and received an investment incentive.

Table 1: Identification of the Selected Company – Investment Incentives

Line of business	Rubber and plastic
Number of employees	231
Registered office	Pardubice Region
Incentives received for	Production facility construction
Investment amount	CZ 162.15 million
Number of jobs created	40
Date of decision regarding	January 2008

Source: Annual reports (2010), CzechInvest (2015). Author's own preparation.

The analysis of the investment costs was carried out at a company that received an investment incentive for reconstruction of the production facility. The reconstruction was completed in 2010, and its operation was commenced at the end of 2010 (Annual report, 2010). The company with around 231 employees is categorised among SMEs. The total amount of planned investments was CZK 162.15 million with 40 newly created jobs. Since the investment incentive was promised in 2008, it is governed by Act No. 72/2000 Coll., on investment incentives, in the wording at the time. This means that a tax discount may be applied for a maximum of 5 years (Chamber of Commerce, 2011).

Table 2 shows the amount of the investment incentive and the size of the sustainable costs for the planned 40 new jobs. Since the company can choose whether to select eligible costs in the form of two-year wages or investments into fixed assets, Table 2 displays both types of eligible costs.

Table 2: Amounts of eligible cost and costs for maintaining an investment incentive (in CZK)

	Applicant’s expectation	Investments into intangible fixed assets (*At least 50 % of investment has to be invested in fixed asset)	Costs for maintaining investments
Planned gross monthly wage	26,000	-	26,000
Planned gross monthly wage	26,000	-	26,000
Planned gross yearly wage	312,000	-	312,000
Planned gross two-year wage	624,000	-	-
Planned number of staff	40	-	40
Costs appropriate for support	24,960,000	81,075,000	12,480,000
Level of public support (in %)	37.50	37.50	-
Value of public support	9,360,000	30,403,125	62,400,000

Source: CzechInvest, 2015. Author's own preparation.

Table 2 presents the amount of eligible costs in the form of two-year wages for the planned 40 employees. It is clear from Table 2 that it is worthwhile for the company to realise the investment incentive calculated from costs into tangible fixed assets, which amounts to CZK 30.4 million. The total costs in the amount of CZK 162.15 million will be increased by the costs that the company must incur for the wages of 40 employees for a five-year period, meaning CZK 62.4 million. The total amount of investments before subtraction of the investment incentive in the amount of CZK 30.4 million is CZK 224.55 million. The amount does not include costs that the company incurred for obtaining the investment incentive, since it has not been possible to calculate their exact amount. Following subtraction of the tax discount of CZK 30.4 million the amount of total investments on the investor's side is CZK 194.15 million. For a better comparison with EU grants, this amount is expressed in percentages from the originally planned investment amount (CZK 162.15 million). The costs that the company incurred for the investment activity with the realised investment incentive amounted to 120 % of the planned investment.

4.2. Company's costs for grants from ESIF

Avoid hyphenation at the end of a line. Symbols denoting vectors and matrices should be indicated in bold type. Scalar variable names should normally be expressed using italics. Weights and measures should be expressed in SI units. All non-standard abbreviations or symbols must be defined when first mentioned, or a glossary provided.

The amount of mentioned preparation time and the demands on applicants cost each company time and with it financial expenses, mainly for a qualified employee involved in preparation of the application. Before the preparation of the application itself, it is necessary to become familiar with and study the operational programme in detail along with the call in which the company wants to submit the project application. Before or during the preparation of the project application, it is recommended to carry out a personal consultation with the manager of the particular operational programme and call for submissions, who serves as an advisory representative and is responsible for evaluating applications after they are submitted. That meeting can enable the company to avoid errors in the project application, which could lead to overall rejection of the application.

Another option for companies is the use of specialised advisory companies involved in grants and processing of custom project applications. The fees for the use of advisory firms' services are derived from the scope of services that the applicant orders. These fees are considered costs for the grant, meaning for its obtaining and maintaining. The research has defined the types of costs that can arise:

1. Application preparation costs – project planning, familiarisation with documents/calls, drafting applications, consultations with providers, preparation of budgets, CBA analysis, finalisation, application submission.

2. Grant/project management – during the realisation of the project, preparation of monitoring reports and requests for payment, including the final accounts of the grant.

3. De facto investments into tangible fixed assets – the investment aim of the project, the company's initial investment with reimbursement of costs for investments at the rate of 50% of the grant. If the project is a non-investment project, such as for employee training (de-facto investment into tangible fixed assets 0.00; grant amount 25–100% of costs).

4. Sustainability costs – related to the operation of generated output or purchased products in the project, during the period after project completion; the requirement is governed by the conditions of individual programmes and calls for submission (e.g. the use of a purchased machine in operation for 3 years from project completion).

Such defined costs have been identified in the research of expert companies, and based on the research the amounts of costs were determined, which the expert firm will claim for rendered services.

1. Application preparation – between CZK 50,000 and 190,000 depending on the complexity of the project and the demands of preparing the project application (including annexes); the budget amount; the OP; etc.

2. Grant management – 1–10% of the investment amount or project budget; grant management refers to full-service grant paperwork, including the preparation of the initial application and all the requests for payment that follow.

3. Investments – cannot be specified, vary depending on the project requirements, grant applicant, OP or call.

4. Sustainability costs – cannot be specified, vary depending on the conditions of the OP and the call.

A project application prepared by an expert company often provides an assurance of fulfilment of basic criteria for selection and approval of the project and eases the lengthy burden for an applicant due to the number of documents related to the programme.

Case study – ESIF grant

For the case study, a company was selected which realised an Enterprise and Innovation OP project under priority axis Development that is the closest in type and focus to the focus of the selected company and the investment incentive. The identification details can be found in Table 3. This company was selected due to the need for appropriate comparison with the company that acquired the investment incentive. In both cases, it is a company identified as an SME, from the Northeast Region, which received a grant or investment incentive during 2007–2013.

Table 3: Identification of selected company – grant from ESIF (in CZK)

Line of business	Production of oils and lubricants
Number of employees	87
Registered office	Liberec Region
Project name	Expansion of a technological foundation
Investment amount	CZK 40 million
Date of signing of grant decision	05/06/2011
Date of payout of grant	24/08/2012
Grant programme	Enterprise and Innovation OP (OPPI), axis Development, call III

Source: CzechInvest (2015-2), Author's own preparation.

Table 4 provides information about individual costs for the selected company during realisation of the grant from OPPI Development.

Table 4: Company's costs when using the grant from OPPI Development (in CZK)

Costs for investments (-)	CZK 40 million
Costs for application preparation (-)	90 thousand
Costs for grant management (14 months) (-)	14 x 10 thousand = 140 thousand
Sustainability costs (-)	cannot be calculated
Grant (+)	CZK 20 million
Total project costs	20,230,000
Total project costs from investment (%)	50.6%

Source: Own preparation based on research.

The costs for project realisation were calculated by the company in the amount of CZK 40 million, which also represents the amount of eligible project costs. The grant from the Development programme reaches 50% of eligible costs. The total grant amount of CZK 20 million was paid following the end of the entire project, which lasted 14 months.

The costs for preparation of the project application have been expert-estimated at CZK 70,000, based on the demands associated with preparing the application and the documents enclosed to it, and the amount of the grant requested. The regular price for grant management ranges between CZK 5,000 and 10,000 per month during the entire project period. In view of the demands and the amount of the grant, the price has been estimated at the higher interval level.

The costs for sustainability in this case cannot be calculated, due to a lack of detailed information about project outputs and requirements for sustainability of the particular outputs. The costs for sustainability of the projects subsidised from ESIF are closely related to outputs and related to maintaining of the particular output for a specific period. In the case of investment projects, this can involve operating costs related to machine purchases, costs for the operation and maintenance of the created line, etc.

The total costs for realisation of the investment project from the OPPI Development programme have been estimated at CZK 20.23 million, which corresponds to 50.6% of the value of the planned investment.

5. Conclusion

The aim of this article was to (i) determine the total costs that a company would have to incur to obtain and maintain investment incentives and grants from ESIF; (ii) compare these costs with each other; (iii) and provide a summary, which from the examined public support contributes to a greater extent to covering of investment costs. In view of the type of public support, the process of application submission and the set conditions, the costs were determined theoretically, and their subsequent proving and quantifying was carried out in the case studies of two companies, one of which received an investment incentive whereas the other one received a grant from ESIF. When searching for the companies that were used for the case studies, it was difficult to find a common denominator so that the companies would at least resemble each other to some extent. The main reason was that investment incentives, in terms of their general requirements, correspond rather to large investment projects; however, SMEs can also receive investment incentives. On the other hand, grants from ESIF are focused on SMEs. Therefore, those Northeast Region companies were selected which qualify as SMEs and received public support in the 2007–2013 programming period.

Costs are incurred early in the beginning, when the company decides whether to use an investment incentive or a grant from ESIF for the planned investment project. This can be attributed to the processes of submitting applications for both types of aid, which require extensive knowledge of the requirements for the particular type. From the applicant's point of view, the application submission process is much more complex for grants from ESIF, since it requires studying of many documents regarding individual OP and the calls in which the company wants to submit the application. In the case of applications for investment incentives, it is necessary for the applicant to fulfil the general conditions, which thanks to their narrow specifications in the corresponding law in relation to the required amount of investments, outputs (newly created jobs) and support for only certain sectors, appear selective in nature. However, the very process of applying for investment incentives is less complex. In both cases, companies can select whether they will submit applications themselves for specific public aid, which is a very time-demanding process, or whether they will submit them in cooperation with an advisory firm. Use of an advisory firm's services saves the company time and can also help avoid errors, which, mainly in the case of grants from ESIF, could result in rejection of the project. However, this incurs additional costs, which may increase depending on the level of the provided services. In the case of the examined company, which received an investment incentive, it was not possible to calculate that type of costs, because information was not available about whether or not the company had used an advisory firm. However, in the case of the ESIF grant, the examined company's costs were estimated at CZK 90,000.

Another type of identified costs is represented by costs for project/grant management. These are costs which arise based on the need for monitoring project realisation and ending. This type of costs was identified only in the case of the ESIF grant. In the monitored company, they amounted to CZK 140,000. These costs are not specified in respect of the investment incentive.

Another type of costs is the de-facto amount of the investment that the investor plans to invest. This amount is important, for example, for investment incentives, where a limit has been set for the minimum supported investment activity. The costs have been calculated for both companies: CZK 162.15 million and CZK 40 million for the investment incentive and the grant, respectively.

The last defined costs related to the monitored public support consist of costs for sustainability of investments. This type of costs cannot be avoided, since there is a legal requirement to create jobs for the duration of the investment incentive, but for at least five years. If this condition were not fulfilled, the supported company would have to return the investment incentive. These costs are also defined for grants. For the case studies, the costs for the investment incentive were figured at CZK 62.4 million, which corresponds to costs for wages for the newly created jobs over a period of five years. In the examined company, which received the grant, it was not possible to calculate the particular costs.

The overall costs for the investment incentive before subtraction of the investment incentive were calculated as CZK 224.55 million. The amount of the investment incentive corresponded to the value of CZK 30.4 million and was calculated from the amount spent for purchasing fixed assets. Following the subtraction of the investment incentive, the total costs are CZK 194.15 million and correspond to 120% of the value of the planned investment. For the ESIF grant, the total amount of investment was CZK 40 million. The grant amounted to half of the planned investment, CZK 20 million. The amount of realised costs was figured at CZK 20.23 million, which corresponds to 50.6%. As is apparent from the calculation, the costs for investment are almost half covered by the grant, which is made possible by retroactive financing. This differs from the investment incentive, which thanks to the need to realise sustainable costs, rather corresponds to partial coverage of sustainable costs instead of covering costs corresponding to the planned investment. It is clear from the case study that the grant from ESIF contributes more to investment costs. Something problematic in relation to this case study is the fact that the recipient of the grant from ESIF is also required to maintain the investments that were the subject of the grant for a certain period, but for the monitored company it was not possible to calculate these costs. What is problematic in respect of the investment incentive is its very basis and the fact it is applied as a tax discount and the company must make profit if it wants to set off the tax incentive against the tax due. However, whether they would be able to make any use of the incentive was rather difficult to estimate for the companies in the period 2007–2013.

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